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SEC FILE NUMBER
8- 15433

**ANNUAL AUDITED REPORT
FORM X-17A-5
PART III**

FACING PAGE

**Information Required of Brokers and Dealers Pursuant to Section 17 of the
Securities Exchange Act of 1934 and Rule 17a-5 Thereunder**

REPORT FOR THE PERIOD BEGINNING 01/01/05 AND ENDING 12/31/05
MM/DD/YY MM/DD/YY

A. REGISTRANT IDENTIFICATION

NAME OF BROKER-DEALER: KMS FINANCIAL SERVICES, INC.

OFFICIAL USE ONLY

ADDRESS OF PRINCIPAL PLACE OF BUSINESS: (Do not use P.O. Box No.)

FIRM I.D. NO.

2001 SIXTH AVENUE, SUITE 2801

(No. and Street)

SEATTLE

(City)

WASHINGTON

(State)

98121

(Zip Code)

NAME AND TELEPHONE NUMBER OF PERSON TO CONTACT IN REGARD TO THIS REPORT

KEN PAULSEN(206) 441-2885

(Area Code - Telephone Number)

B. ACCOUNTANT IDENTIFICATION

INDEPENDENT PUBLIC ACCOUNTANT whose opinion is contained in this Report*

HAGELIN & ASSOCIATES

(Name - if individual, state last, first, middle name)

2200 SIXTH AVENUE, SUITE 430 SEATTLE, WASHINGTON 98121

(Address)

(City)

(State)

(Zip Code)

CHECK ONE:

☒ Certified Public Accountant☐ Public Accountant☐ Accountant not resident in United States or any of its possessions.

PROCESSED

MAY 24 2006

THOMSON
FINANCIAL

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*Claims for exemption from the requirement that the annual report be covered by the opinion of an independent public accountant must be supported by a statement of facts and circumstances relied on as the basis for the exemption. See Section 240.17a-5(e)(2)

SEC 1410 (06-02)

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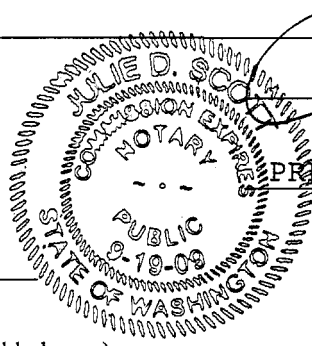
OATH OR AFFIRMATION

I, MARK HAMBY, swear (or affirm) that, to the best of my knowledge and belief the accompanying financial statement and supporting schedules pertaining to the firm of KMS FINANCIAL SERVICES, INC., as of DECEMBER 31, 2005, are true and correct. I further swear (or affirm) that neither the company nor any partner, proprietor, principal officer or director has any proprietary interest in any account classified solely as that of a customer, except as follows:

NONE

Julie D Scott

Notary Public



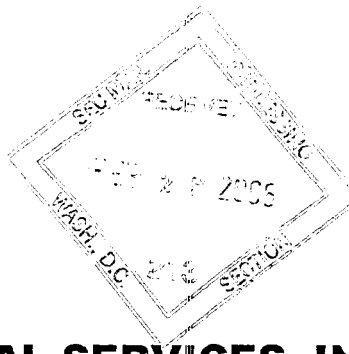
[Signature]
Signature

PRESIDENT, CEO
Title

This report ** contains (check all applicable boxes):

- ☒ (a) Facing Page.
- ☒ (b) Statement of Financial Condition.
- ☒ (c) Statement of Income (Loss).
- ☒ (d) Statement of Changes in ~~Financial Condition~~ cash flows.
- ☒ (e) Statement of Changes in Stockholders' Equity or Partners' or Sole Proprietors' Capital.
- ☐ (f) Statement of Changes in Liabilities Subordinated to Claims of Creditors.
- ☒ (g) Computation of Net Capital.
- ☐ (h) Computation for Determination of Reserve Requirements Pursuant to Rule 15c3-3.
- ☐ (i) Information Relating to the Possession or Control Requirements Under Rule 15c3-3.
- ☒ (j) A Reconciliation, including appropriate explanation of the Computation of Net Capital Under Rule 15c3-1 and the Computation for Determination of the Reserve Requirements Under Exhibit A of Rule 15c3-3.
- ☐ (k) A Reconciliation between the audited and unaudited Statements of Financial Condition with respect to methods of consolidation.
- ☒ (l) An Oath or Affirmation.
- ☐ (m) A copy of the SIPC Supplemental Report.
- ☐ (n) A report describing any material inadequacies found to exist or found to have existed since the date of the previous audit.
- ☒ (o) Independent auditor's report on internal control.

**For conditions of confidential treatment of certain portions of this filing, see section 240.17a-5(e)(3).



KMS FINANCIAL SERVICES, INC.

Audited Financial Statements

Financial and Operational Combined Uniform

Single Report – Parts III and IIA

Independent Auditor's Report on Internal Control

December 31, 2005

HAGELIN & ASSOCIATES
CERTIFIED PUBLIC ACCOUNTANTS

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HAGELIN & ASSOCIATES
CERTIFIED PUBLIC ACCOUNTANTS
2200 Sixth Avenue, Suite 430
Seattle, WA 98121-1845

(206) 441-7100
FAX (206) 441-5804

INDEPENDENT AUDITOR'S REPORT

Board of Directors
KMS Financial Services, Inc.

We have audited the accompanying statement of financial condition of KMS Financial Services, Inc. as of December 31, 2005, and the related statements of income, stockholders' equity, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of KMS Financial Services, Inc. as of December 31, 2005, and the results of its operations and its cash flows for the year then ended in conformity with United States of America generally accepted accounting principles.

Hagelin & Associates

Seattle, Washington

February 14, 2006

KMS FINANCIAL SERVICES, INC.
STATEMENT OF FINANCIAL CONDITION
December 31, 2005

ASSETS

Cash and cash equivalents	\$5,255,527
Commissions receivable, net of allowance for doubtful accounts	2,184,591
Investments in common stocks and U.S. Treasury Notes, at market value	1,157,895
Prepaid expenses and other receivables	27,532
Advances to registered representatives	39,999
Deposits with clearing organizations	140,000
Office equipment and fine art at cost, net of accumulated depreciation of \$681,133	154,474
Deferred Federal income tax asset	175,000
	<u>\$9,135,018</u>

LIABILITIES AND STOCKHOLDERS' EQUITY

Accounts payable	\$ 448,694
Commissions payable	1,674,491
Payable to customers	86,443
Profit sharing contribution payable	478,938
Accrued expenses	49,218
Federal and state income taxes currently payable	219,514
Supplemental retirement payable	684,970
	<u>3,642,268</u>
Commitments and contingent liabilities	
Stockholders' equity:	
Common stock - no par value:	
Authorized - 50,000 shares, issued and outstanding - 13,112 shares	255,217
Retained earnings	5,237,533
	<u>5,492,750</u>
	<u>\$9,135,018</u>

See notes to financial statements.

KMS FINANCIAL SERVICES, INC.
STATEMENT OF INCOME
For the year ended December 31, 2005

REVENUES

Commissions	\$43,045,582
Interest income	142,536
Other income	1,815,948
Total revenues	<u>45,004,066</u>

EXPENSES

Commission expense	38,793,340
Salaries	2,178,062
Supplemental executive retirement	42,027
Payroll taxes	158,010
Employee benefits	130,200
Profit sharing plan expense	485,085
Rent	123,823
Promotion, entertainment and sales expense	32,924
Office expenses	105,874
Telephone	15,217
Research and sundry	574,343
Data processing	49,910
Repairs and maintenance	7,786
Professional fees	252,079
Business taxes	226,953
Registration fees and expenses	109,477
Insurance	60,762
Interest	54
Dues and subscriptions	11,555
Miscellaneous	39,735
Depreciation and amortization	106,226
Total expenses	<u>43,503,442</u>

INCOME BEFORE INCOME TAXES 1,500,624

PROVISION FOR INCOME TAXES 529,223

NET INCOME \$ 971,401

See notes to financial statements.

KMS FINANCIAL SERVICES, INC.
STATEMENT OF STOCKHOLDERS' EQUITY
For the year ended December 31, 2005

	<u>Common Stock</u>		<u>Retained</u>
	<u>Shares</u>	<u>Dollars</u>	<u>Earnings</u>
Balance - December 31, 2004	13,377	\$260,374	\$4,431,180
(Redemption) and cancellation of common shares	(265)	(5,157)	(165,048)
Net income for the year			<u>971,401</u>
Balance - December 31, 2005	<u>13,112</u>	<u>\$255,217</u>	<u>\$5,237,533</u>

See notes to financial statements.

KMS FINANCIAL SERVICES, INC.
STATEMENT OF CASH FLOWS
For the year ended December 31, 2005
Increase (Decrease) in Cash and Cash Equivalents

CASH FLOWS FROM OPERATING ACTIVITIES

Net income	\$ 971,401
Adjustment to reconcile net income to net cash provided by operating activities:	
Depreciation and amortization	106,226
(Increase) decrease in:	
Commissions receivable	(357,346)
Investments	21,352
Prepaid expenses and other receivables	17,368
Advances to registered representatives	(27,229)
Deferred Federal income tax asset	(50,000)
Increase (decrease) in:	
Accounts payable	197,493
Commissions payable	167,907
Payable to customers	24,928
Accrued expenses	40,136
Federal and state income taxes payable	79,514
Supplemental retirement payable	(17,973)
NET CASH FLOWS FROM OPERATING ACTIVITIES	<u>1,173,777</u>

CASH FLOWS FROM INVESTING ACTIVITIES

Purchase of office equipment and fine art	(81,417)
NET CASH FLOWS (USED IN) INVESTING ACTIVITIES	<u>(81,417)</u>

CASH FLOWS FROM FINANCING ACTIVITIES

Redemption and cancellation of shares	(170,205)
NET CASH FLOWS (USED IN) FINANCING ACTIVITIES	<u>(170,205)</u>

NET INCREASE IN CASH AND CASH EQUIVALENTS 922,155

CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR 4,333,372

CASH AND CASH EQUIVALENTS AT END OF YEAR \$5,255,527

See notes to financial statements.

KMS FINANCIAL SERVICES, INC.
NOTES TO FINANCIAL STATEMENTS

1. THE COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

THE COMPANY - The Company is a NASD Registered Broker and Dealer, Securities and Exchange Commission registered investment advisor, and insurance general agent offering securities, investment advisory services and insurance products through independent contractor agents (registered representatives and investment advisory representatives) in the Western United States. Commission revenues are generated predominantly from the sale of mutual fund shares, general securities and variable annuities. Investment advisory revenues are generated primarily through offering investment advisory services based on a percentage of assets under advisory contracts.

INCOME RECOGNITION - Securities transactions and the commission revenue and expense are recorded in the accounts on a trade date basis. Investment advisory fees are received quarterly but are recognized as earned on a pro rata basis over the term of the agreement.

INCOME TAXES - Deferred Federal income taxes are provided when income, related to carrying investments at market value, and expenses, principally supplemental executive retirement program expenses accrued for financial statement purposes not deductible for tax purposes until paid, are recognized in different years for tax and financial statement purposes. Deferred tax expenses or benefits are recognized in the financial statements for the changes in the deferred tax liabilities or assets between years. No valuation allowances have been recorded to offset deferred tax assets recorded by the Company.

FIXED ASSETS AND DEPRECIATION - Office equipment and fine art are stated at cost. Office equipment is depreciated over its estimated economic life, ranging from three to seven years and is computed on the straight-line and accelerated methods. Fine art is depreciated on the straight-line method over its estimated economic lives of twenty to fifty years.

INVESTMENTS - Investments in common stocks, mutual funds and U.S. Treasury Notes are carried at fair market value based upon quoted market prices.

ESTIMATES AND ASSUMPTIONS - Management uses estimates and assumptions in preparing financial statements. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses.

KMS FINANCIAL SERVICES, INC.
NOTES TO FINANCIAL STATEMENTS
(continued)

1. THE COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(continued)

FAIR VALUE OF FINANCIAL INSTRUMENTS - The carrying value of cash, receivables and accounts payable approximate fair value due to the short maturity of these instruments. None of the financial instruments are held for trading purposes.

2. CASH AND CASH EQUIVALENTS

The Company considers cash and cash equivalents to include cash and those short-term, highly liquid investments with original maturities of three months or less.

Cash and cash equivalents at December 31, 2005 consist of the following:

General funds	\$ 100,763
Cash segregated in compliance with Federal and other regulations	118,095
Cash segregated in compliance with agreements with registered representatives (Note 5)	255,969
Investments in money market funds	<u>4,780,700</u>
	<u>\$5,255,527</u>

Supplemental disclosures for the statement of cash flows include cash paid during the year for:

Interest	\$ 54
Income taxes (Note 6)	\$499,709

3. NET CAPITAL REQUIREMENTS

The Company is subject to the Securities and Exchange Commission Uniform Net Capital Rule (Rule 15c3-1), which requires the maintenance of minimum net capital and requires that the ratio of aggregate indebtedness to net capital, both as defined, shall not exceed 15 to 1.

At December 31, 2005, the Company had net capital of \$4,385,000 and net capital required under the Rule was \$250,000. The aggregate indebtedness to net capital ratio was 0.83 to 1.

The net capital rules may effectively restrict the payment of cash dividends.

KMS FINANCIAL SERVICES, INC.
NOTES TO FINANCIAL STATEMENTS
(continued)

4. SUPPLEMENTAL EXECUTIVE RETIREMENT PROGRAM

The Company maintains a supplemental executive retirement program covering an employee that provided for monthly benefits of \$5,000 commencing in 1998. The Company's policy is to not fund the liability. The unfunded accumulated benefit obligation is reflected in the accompanying financial statements as supplemental retirement payable.

5. COMMITMENTS

The Company leases office premises and equipment under noncancelable operating leases. The Company is obligated under an equipment lease for rental payments covering office supplies provided under the operating lease. The following is a schedule by years of future minimum rental payments required under operating leases that have initial or remaining noncancelable lease terms in excess of one year as of December 31, 2005:

<u>Year ending December 31,</u>	
2006	\$ 150,444
2007	129,270
2008	127,992
2009	131,868
2010	139,776
Thereafter	<u>562,980</u>
Total minimum payments required	<u>\$1,242,330</u>

The Company's rental expense, under operating leases, was \$123,823 during 2005.

The Company has received payments from registered representatives, and maintains the funds to supplement professional liability insurance programs as necessary. The Company, and appointed registered representatives are responsible for administration of funds.

The Company is obligated to purchase, from certain stockholder's estates, the estate's common stock at a purchase price per share determined by formula. Additionally, the Company is obligated to purchase shares from certain terminated employees.

The Company maintains life insurance on certain stockholders. Proceeds from these life insurance policies are to be used to redeem common stock from the estate, with balances generally payable over five years at prime rates plus one percent.

KMS FINANCIAL SERVICES, INC.
NOTES TO FINANCIAL STATEMENTS
(continued)

6. INCOME TAXES

The Company's provision for income taxes consist of the following components:

Currently payable	\$579,223
Deferred tax (benefit)	<u>(50,000)</u>
	<u>\$529,223</u>

The Company's deferred Federal tax asset represents the tax effects of deductible temporary differences in reporting compensation and retirement benefits under terms of the supplemental executive retirement program covering an officer.

The Company's deferred Federal income tax payable represent the tax effects of taxable temporary differences in carrying investments in common stocks and U.S. Treasury Notes at fair market value for financial presentation purposes. The net deferred Federal income tax asset includes the asset, net of the payable.

The Company's provision for income taxes differs from applying the statutory U.S. Federal income tax rate to income before income taxes. The primary difference results from providing for state income taxes.

7. EMPLOYEE PENSION AND PROFIT SHARING PLAN

The Company's employees are participants in a pension and profit sharing plan revised effective January 1, 2002. The plan covers substantially all of the Company's employees.

The plan is a 401(k) plan where the employees may elect to make voluntary contributions pursuant to a salary reduction agreement. The Company is obligated for minimum contributions, and may elect to make additional discretionary contributions determined by the Board of Directors. Contributions cannot exceed twenty five percent of compensation. Contributions of \$485,085 (including \$64,025 of required minimum contributions) were authorized by the Board of Directors for 2005. The Company is obligated for contributions to the pension plan of three percent of eligible compensation, as defined, on an annual basis. The Company funds plan contributions as incurred.

KMS FINANCIAL SERVICES, INC.
NOTES TO FINANCIAL STATEMENTS
(continued)

8. CONTINGENT LIABILITIES

The Company maintains its cash accounts in one commercial bank located in Seattle, Washington. The total cash balances are secured by the Federal Deposit Insurance Corporation up to \$100,000. Additionally, investments in money market funds are not secured.

The Company is involved in various legal actions and claims arising in the normal course of business. After taking into consideration legal counsel's evaluation of such actions, management is of the opinion that their outcome will not result in any material adverse effect on the Company's financial position.

HAGELIN & ASSOCIATES
CERTIFIED PUBLIC ACCOUNTANTS
2200 Sixth Avenue, Suite 430
Seattle, WA 98121-1845

(206) 441-7100
FAX (206) 441-5804

INDEPENDENT AUDITOR'S REPORT ON
SUPPLEMENTARY INFORMATION REQUIRED BY RULE 17a-5 OF THE
SECURITIES AND EXCHANGE COMMISSION

Board of Directors
KMS Financial Services, Inc.

We have audited the accompanying financial statements of KMS Financial Services, Inc. as of and for the year ended December 31, 2005, and have issued our report thereon dated February 14, 2006. Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The information contained in pages 15 - 25 is presented for purposes of additional analysis and is not a required part of the basic financial statements, but is supplementary information required by Rule 17a-5 of the Securities and Exchange Commission. Such information has been subjected to the United States of America auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Hagelin & Associates

Seattle, Washington

February 14, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

OMB APPROVAL	
OMB Number:	3235-0123
Expires:	October 31, 2005
Estimated average burden hours per response.....	12.00

Form
X-17A-5

FOCUS REPORT
(Financial and Operational Combined Uniform Single Report)
PART IIA 12

(Please read instructions before preparing Form.)

This report is being filed pursuant to (Check Applicable Block(s)):

1) Rule 17a-5(a) 16

2) Rule 17a-5(b) 17

3) Rule 17a-11 18

4) Special request by designated examining authority 19

5) Other X 26 Rule 17a-5(d)

NAME OF BROKER-DEALER

SEC FILE NO.

KMS FINANCIAL SERVICES, INC. 13

8-15433 14

ADDRESS OF PRINCIPAL PLACE OF BUSINESS (Do Not Use P.O. Box No.)

FIRM I.D. NO.

2001 SIXTH AVENUE, SUITE 2801 20

01-03866 15

(No. and Street)

FOR PERIOD BEGINNING (MM/DD/YY)

SEATTLE 21

WASHINGTON 22

98121 23

01/01/05 24

(City)

(State)

(Zip Code)

AND ENDING (MM/DD/YY)

12/31/05 25

NAME AND TELEPHONE NUMBER OF PERSON TO CONTACT IN REGARD TO THIS REPORT

(Area Code) — Telephone No.

KEN PAULSEN 30

(206) 441-2885 31

NAME(S) OF SUBSIDIARIES OR AFFILIATES CONSOLIDATED IN THIS REPORT:

OFFICIAL USE

32

33

34

35

36

37

38

39

DOES RESPONDENT CARRY ITS OWN CUSTOMER ACCOUNTS? YES 40 NO XX 41

CHECK HERE IF RESPONDENT IS FILING AN AUDITED REPORT XX 42

EXECUTION:

The registrant/broker or dealer submitting this Form and its attachments and the person(s) by whom it is executed represent hereby that all information contained therein is true, correct and complete. It is understood that all required items, statements, and schedules are considered integral parts of this Form and that the submission of any amendment represents that all unamended items, statements and schedules remain true, correct and complete as previously submitted.

Dated the 24TH day of FEBRUARY 2006

Manual signatures of:

1)

Principal Executive Officer or Managing Partner

2)

Principal Financial Officer or Partner

3)

Principal Operations Officer or Partner

ATTENTION — Intentional misstatements or omissions of facts constitute Federal Criminal Violations. (See 18 U.S.C. 1001 and 15 U.S.C. 78f(a))

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SEC 1696 (02-03)

TO BE COMPLETED WITH THE ANNUAL AUDIT REPORT ONLY:

INDEPENDENT PUBLIC ACCOUNTANT whose opinion is contained in this Report

NAME (If individual, state last, first, middle name)

HAGELIN & ASSOCIATES

70

ADDRESS

2200 SIXTH AVENUE, #430

71

SEATTLE

72

WASHINGTON

73

98121

74

Number and Street

City

State

Zip Code

CHECK ONE

☒ Certified Public Accountant

75

☐ Public Accountant

76

☐ Accountant not resident in United States
or any of its possessions

77

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FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT

PART IIA

BROKER OR DEALER **KMS FINANCIAL SERVICES, INC.**

N 3

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STATEMENT OF FINANCIAL CONDITION FOR NONCARRYING, NONCLEARING AND CERTAIN OTHER BROKERS OR DEALERS

as of (MM/DD/YY) **12/31/05**

SEC FILE NO. **8-15433**

Consolidated ☐ 99
Unconsolidated ☒ 98
198
199

	Allowable	Non-Allowable	Total
1. Cash	\$ 218,858 200		\$ 218,858 750
2. Receivables from brokers or dealers:			
A. Clearance account	295		
B. Other	1,672,857 300	\$ 511,734 550	2,184,591 810
3. Receivable from non-customers	355	600	830
4. Securities and spot commodities owned at market value:			
A. Exempted securities	418		
B. Debt securities	5,639,708 419		
C. Options	420		
D. Other securities	554,856 424		
E. Spot commodities	430		6,194,564 850
5. Securities and/or other investments not readily marketable:			
A. At cost \$	130		
B. At estimated fair value	440	610	860
6. Securities borrowed under subordination agreements and partners' individual and capital securities accounts, at market value:			
A. Exempted securities \$	150		
B. Other securities \$	160		
7. Secured demand notes:			
Market value of collateral:			
A. Exempted securities \$	170		
B. Other securities \$	180		
8. Memberships in exchanges:			
A. Owned, at market \$	190		
B. Owned, at cost		650	
C. Contributed for use of the company, at market value		660	900
9. Investment in and receivables from affiliates, subsidiaries and associated partnerships	480	670	910
10. Property, furniture, equipment, leasehold improvements and rights under lease agreements, at cost-net of accumulated depreciation and amortization	490	154,474 680	154,474 920
11. Other assets	140,000 535	242,531 735	382,531 930
12. TOTAL ASSETS	\$ 8,226,279 540	\$ 908,739 740	\$ 9,135,018 940

OMIT PENNIES

SEC 1696 (02-03)

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT

PART IIA

BROKER OR DEALER **KMS FINANCIAL SERVICES, INC.**

as of 12/31/05

STATEMENT OF FINANCIAL CONDITION FOR NONCARRYING, NONCLEARING AND CERTAIN OTHER BROKERS OR DEALERS

LIABILITIES AND OWNERSHIP EQUITY

<u>Liabilities</u>	<u>A.I. Liabilities</u>	<u>Non-A.I. Liabilities</u>	<u>Total</u>
13. Bank loans payable	\$ 1045	\$ 1255 ¹³	\$ 1470
14. Payable to brokers or dealers:			
A. Clearance account	1114	1315	1560
B. Other	1,674,491 ¹⁰ 1115	1305	1,674,491 1540
15. Payable to non-customers	86,443 1155	1355	86,443 1610
16. Securities sold not yet purchased, at market value		1360	1620
17. Accounts payable, accrued liabilities, expenses and other	1,881,334 1205	1385	1,881,334 1685
18. Notes and mortgages payable:			
A. Unsecured	1210		1690
B. Secured	1211 ¹²	1390 ¹⁴	1700
19. E. Liabilities subordinated to claims of general creditors:			
A. Cash borrowings:		1400	1710
1. from outsiders ⁹ \$ 970			
2. includes equity subordination (15c3-1(d)) of ... \$ 980		1410	1720
B. Securities borrowings, at market value			
from outsiders \$ 990		1420	1730
C. Pursuant to secured demand note collateral agreements			
1. from outsiders \$ 1000			
2. includes equity subordination (15c3-1(d)) of ... \$ 1010		1430	1740
D. Exchange memberships contributed for use of company, at market value			
E. Accounts and other borrowings not qualified for net capital purposes	1220	1440	1750
20. TOTAL LIABILITIES	\$ 3,642,268 1230	\$ 1450	\$ 3,642,268 1760
<u>Ownership Equity</u>			
21. Sole Proprietorship			1770
22. Partnership (limited partners)	11 (\$ 1020)		1780
23. Corporation:			
A. Preferred stock			1791
B. Common stock		255,217	1792
C. Additional paid-in capital			1793
D. Retained earnings		5,237,533	1794
E. Total		5,492,750	1795
F. Less capital stock in treasury		1796 ¹⁶	1796
24. TOTAL OWNERSHIP EQUITY		\$ 5,492,750	1800
25. TOTAL LIABILITIES AND OWNERSHIP EQUITY		\$ 9,135,018	1810

OMIT PENNIES

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT

PART IIA

BROKER OR DEALER **KMS FINANCIAL SERVICES, INC.**

as of 12/31/05

COMPUTATION OF NET CAPITAL

1. Total ownership equity from Statement of Financial Condition	\$ 5,492,750	3480
2. Deduct ownership equity not allowable for Net Capital	18 ()	3490
3. Total ownership equity qualified for Net Capital	5,492,750	3500
4. Add:		
A. Liabilities subordinated to claims of general creditors allowable in computation of net capital		3520
B. Other (deductions) or allowable credits (List)		3525
5. Total capital and allowable subordinated liabilities	\$ 5,492,750	3530
6. Deductions and/or charges:		
A. Total non-allowable assets from		
Statement of Financial Condition (Notes B and C)	17 \$ 908,739	3540
B. Secured demand note delinquency		3590
C. Commodity futures contracts and spot commodities -		
proprietary capital charges		3600
D. Other deductions and/or charges		3610
7. Other additions and/or allowable credits (List)	(908,739)	3620
8. Net capital before haircuts on securities positions	20 \$ 4,584,011	3630
9. Haircuts on securities (computed, where applicable, pursuant to 15c3-1(f)):		
A. Contractual securities commitments	\$	3660
B. Subordinated securities borrowings		3670
C. Trading and investment securities:		
1. Exempted securities	18	3735
2. Debt securities	115,415	3733
3. Options		3730
4. Other securities	83,228	3734
D. Undue Concentration		3650
E. Other (List)		3736
	(198,643)	3740
10. Net Capital	\$ 4,385,368	3750

OMIT PENNIES

SEC 1696 (02-03)

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT

PART IIA

BROKER OR DEALER **KMS FINANCIAL SERVICES, INC.**

as of **12/31/05**

COMPUTATION OF NET CAPITAL REQUIREMENT

Part A

11. Minimum net capital required (6% of line 19)	\$	242,818	3756
12. Minimum dollar net capital requirement of reporting broker or dealer and minimum net capital requirement of subsidiaries computed in accordance with Note (A)	\$	250,000	3758
13. Net capital requirement (greater of line 11 or 12)	\$	250,000	3760
14. Excess net capital (line 10 less 13)	\$	4,135,368	3770
15. Excess net capital at 1000% (line 10 less 10% of line 19)	\$	4,021,141	3780

COMPUTATION OF AGGREGATE INDEBTEDNESS

16. Total A.I. liabilities from Statement of Financial Condition	\$	3,642,268	3790
17. Add:			
A. Drafts for immediate credit	\$	3800	
B. Market value of securities borrowed for which no equivalent value is paid or credited	\$	3810	
C. Other unrecorded amounts (List)	\$	3820	
18. Total aggregate indebtedness	\$	3,642,268	3840
19. Percentage of aggregate indebtedness to net capital (line 18 ÷ by line 10)	%	.83 TO 1	3850
20. Percentage of debt to debt-equity total computed in accordance with Rule 15c3-1(d)	%	N/A	3860

COMPUTATION OF ALTERNATE NET CAPITAL REQUIREMENT

Part B

21. 2% of combined aggregate debit items as shown in Formula for Reserve Requirements pursuant to Rule 15c3-3 prepared as of the date of the net capital computation including both brokers or dealers and consolidated subsidiaries' debits	\$	N/A	3970
22. Minimum dollar net capital requirement of reporting broker or dealer and minimum net capital requirement of subsidiaries computed in accordance with Note (A)	\$	3880	3880
23. Net capital requirement (greater of line 21 or 22)	\$	3760	3760
24. Excess capital (line 10 less 23)	\$	3910	3910
25. Net capital in excess of the greater of:			
A. 5% of combined aggregate debit items or \$120,000	\$	3920	3920

NOTES:

- (A) The minimum net capital requirement should be computed by adding the minimum dollar net capital requirement of the reporting broker dealer and, for each subsidiary to be consolidated, the greater of:
1. Minimum dollar net capital requirement, or
 2. 6% of aggregate indebtedness or 4% of aggregate debits if alternative method is used.
- (B) Do not deduct the value of securities borrowed under subordination agreements or secured demand note covered by subordination agreements not in satisfactory form and the market values of memberships in exchanges contributed for use of company (contra to item 1740) and partners' securities which were included in non-allowable assets.
- (C) For reports filed pursuant to paragraph (d) of Rule 17a-5, respondent should provide a list of material non-allowable assets.

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT

PART IIA

BROKER OR DEALER KMS FINANCIAL SERVICES, INC.

For the period (MMDDYY) from 010105 3932 to 123105 3933
 Number of months included in this statement 12 3931

STATEMENT OF INCOME (LOSS)

REVENUE

1. Commissions:		
a. Commissions on transactions in exchange listed equity securities executed on an exchange	\$ 1,923,988	3935
b. Commissions on listed option transactions		3938
c. All other securities commissions	9,810,803	3939
d. Total securities commissions		3940
2. Gains or losses on firm securities trading accounts		
a. From market making in options on a national securities exchange		3945
b. From all other trading		3949
c. Total gain (loss)	(17,456)	3952
3. Gains or losses on firm securities investment accounts		3955
4. Profit (loss) from underwriting and selling groups		3970
5. Revenue from sale of investment company shares	19,973,830	3990
6. Commodities revenue		3995
7. Fees for account supervision, investment advisory and administrative services	10,948,245	3995
8. Other revenue	2,364,656	4030
9. Total revenue	\$45,004,066	

EXPENSES

10. Salaries and other employment costs for general partners and voting stockholder officers	1,709,373	4120
11. Other employee compensation and benefits	1,370,579	4115
12. Commissions paid to other broker-dealers		4140
13. Interest expense	54	4075
a. Includes interest on accounts subject to subordination agreements	4070	
14. Regulatory fees and expenses	109,327	4195
15. Other expenses	40,337,332	4100
16. Total expenses	\$43,526,665	4200

NET INCOME

17. Income (loss) before Federal income taxes and items below (Item 9 less Item 16)	\$ 1,477,401	4210
18. Provision for Federal income taxes (for parent only)	506,000	4220
19. Equity in earnings (losses) of unconsolidated subsidiaries not included above		4222
a. After Federal income taxes of	4338	
20. Extraordinary gains (losses)		4224
a. After Federal income taxes of	4239	
21. Cumulative effect of changes in accounting principles		4225
22. Net income (loss) after Federal income taxes and extraordinary items	\$ 971,401	4230

MONTHLY INCOME

23. Income (current month only) before provision for Federal income taxes and extraordinary items	\$	N/A	4211
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FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT

PART IIA

BROKER OR DEALER KMS FINANCIAL SERVICES, INC.

For the period (MMDDYY) from 010105 to 123105

STATEMENT OF CHANGES IN OWNERSHIP EQUITY (SOLE PROPRIETORSHIP, PARTNERSHIP OR CORPORATION)

1. Balance, beginning of period	\$	4,691,554	4240
A. Net income (loss)		971,401	4250
B. Additions (Includes non-conforming capital of	\$	4262	4260
C. Deductions (Includes non-conforming capital of	\$	NONE	4270
2. Balance, end of period (From item 1800)	\$	5,492,750	4290

STATEMENT OF CHANGES IN LIABILITIES SUBORDINATED TO CLAIMS OF GENERAL CREDITORS

3. Balance, beginning of period	\$	N/A	4300
A. Increases			4310
B. Decreases			4320
4. Balance, end of period (From item 3520)	\$	N/A	4330

OMIT PENNIES

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT

PART IIA

BROKER OR DEALER **KMS FINANCIAL SERVICES, INC.**

as of **12/31/05**

EXEMPTIVE PROVISION UNDER RULE 15c3-3

24. If an exemption from Rule 15c3-1 is claimed, identify below the section upon which such exemption is based (check one only)

- A. (k)(1) — \$2,500 capital category as per Rule 15c3-1 4550
- B. (k)(2)(A) — "Special Account for the Exclusive Benefit of customers" maintained 4560
- C. (k)(2)(B) — All customer transactions cleared through another broker-dealer on a fully disclosed basis.
 Name of clearing firm³⁰ **PERSHING, LLC** 4335 X 4570
- D. (k)(3) — Exempted by order of the Commission (include copy of letter) 4580

CLEARING FIRM SEC #: 8-17574

Ownership Equity and Subordinated Liabilities maturing or proposed to be withdrawn within the next six months and accruals, (as defined below), which have not been deducted in the computation of Net Capital.

Type of Proposed Withdrawal or Accrual (See below for code)	Name of Lender or Contributor	Insider or Outsider? (In or Out)	Amount to be Withdrawn (cash amount and/or Net Capital Value of Securities)	(MMDDYY) Withdrawal or Maturity Date	Expect to Renew (Yes or No)
31 1 4600	WESTBERG	4601 IN 4602	161,594	4603 021006 4604	NO 4605
32 4610		4611 4612		4613 4614	4615
33 4620		4621 4622		4623 4624	4625
34 4630		4631 4632		4633 4634	4635
35 4640		4641 4642		4643 4644	4645
			Total \$ ³⁶ 161,594	4699	

OMIT PENNIES

Instructions: Detail Listing must include the total of items maturing during the six month period following the report date, regardless of whether or not the capital contribution is expected to be renewed. The schedule must also include proposed capital withdrawals scheduled within the six month period following the report date including the proposed redemption of stock and anticipated accruals which would cause a reduction of Net Capital. These anticipated accruals would include amounts of bonuses, partners' drawing accounts, taxes, and interest on capital, voluntary contributions to pension or profit sharing plans, etc., which have not been deducted in the computation of Net Capital, but which you anticipate will be paid within the next six months.

WITHDRAWAL CODE:	DESCRIPTIONS
1.	Equity Capital
2.	Subordinated Liabilities
3.	Accruals

SEC 1696 (02-03)

KMS FINANCIAL SERVICES, INC.
COMPUTATION OF NET CAPITAL UNDER RULE 15c3-1 OF THE
SECURITIES AND EXCHANGE COMMISSION
December 31, 2005

NET CAPITAL

Total stockholder's equity qualified for net capital		\$5,492,750
Deductions and/or charges:		
A. Non-allowable assets		
Property, furniture, equipment and leasehold improvements (net of accumulated depreciation)	\$154,474	
Receivable from brokers or dealers, other	511,734	
Other receivables and prepaid expenses	202,532	
Advances to registered representatives	39,999	
		<u>908,739</u>
Net capital before haircuts on securities positions		<u>4,584,011</u>
Haircuts on securities (computed, where applicable, pursuant to Rule 15c3-1(f)):		
C. Trading and investment securities		
2. Debt securities		115,415
4. Other securities		83,228
Net capital		<u>\$4,385,368</u>

AGGREGATE INDEBTEDNESS

Items included in statement of financial condition		
Payable to brokers or dealers	\$	86,443
Accounts payable		448,694
Accrued expenses and other liabilities		747,670
Commissions payable		1,674,491
Deferred retirement payable		684,970
Total aggregate indebtedness		<u>\$3,642,268</u>

COMPUTATION OF BASIS NET CAPITAL REQUIREMENT

Minimum net capital required	<u>\$242,818</u>
Minimum dollar net capital required of reporting broker or dealer	<u>\$250,000</u>
Excess net capital	<u>\$4,135,368</u>
Excess net capital at 1000%	<u>\$4,021,141</u>
Ratio: Aggregate indebtedness to net capital	<u>0.83 to 1</u>

KMS FINANCIAL SERVICES, INC.
COMPUTATION OF NET CAPITAL UNDER RULE 15c3-1 OF THE
SECURITIES AND EXCHANGE COMMISSION
(Continued)
December 31, 2005

RECONCILIATION WITH COMPANY'S COMPUTATION

(included in Part IIA of Form X-17A-5 as
of December 31, 2005)

Net capital, as reported in Company's Part IIA (Unaudited) FOCUS report	\$4,516,155
Audit adjustments increasing (decreasing) assets	
Commissions receivable	370,000
Unsecured debits	(1,634)
Audit adjustments (increasing) nonallowable assets	(36,785)
Audit adjustments decreasing (increasing) A.I. Liabilities	
Trade accounts payable	(5,498)
Commissions payable	(334,850)
Federal income taxes currently payable	(114,521)
Accrued expenses and other liabilities	(113)
Audit adjustments (increasing) Haircuts on securities	(7,386)
Net capital as computed per this schedule	<u>\$4,385,368</u>

HAGELIN & ASSOCIATES
CERTIFIED PUBLIC ACCOUNTANTS
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Seattle, WA 98121-1845

(206) 441-7100
FAX (206) 441-5804

INDEPENDENT AUDITOR'S REPORT ON INTERNAL
CONTROL REQUIRED BY RULE 17a-5 OF THE
SECURITIES AND EXCHANGE COMMISSION

Board of Directors
KMS Financial Services, Inc.

We have audited the financial statements of KMS Financial Services, Inc. as of and for the year ended December 31, 2005, and have issued our report thereon dated February 14, 2006. In planning and performing our audit of the financial statements and supplemental schedules of KMS Financial Services, Inc. for the year ended December 31, 2005, we considered its internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on internal control.

Also, as required by Rule 17a-5(g)(1) of the Securities and Exchange Commission, we have made a study of the practices and procedures (including tests of compliance with such practices and procedures) followed by KMS Financial Services, Inc. that we considered relevant to the objectives stated in Rule 17a-5(g) in making the periodic computations of aggregate indebtedness (or aggregate debits) and net capital under Rule 17a-3(a)(11) and the procedures for determining compliance with the exemptive provisions of Rule 15c3-3.

Because the Company does not carry securities accounts for customers or perform custodial functions relating to customer securities, we did not review the practices and procedures followed by the Company in any of the following:

1. Making the quarterly securities examinations, counts, verifications and comparisons.
2. Recordation of differences required by Rule 17a-13.
3. Complying with the requirements for prompt payment for securities under Section 8 of Federal Reserve Regulation T of the Board of Governors of the Federal Reserve System.

INDEPENDENT AUDITOR'S REPORT ON INTERNAL
CONTROL REQUIRED BY RULE 17a-5 OF THE
SECURITIES AND EXCHANGE COMMISSION

(Continued)

The management of the Company is responsible for establishing and maintaining internal control and the practices and procedures referred to in the preceding paragraph. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of controls and of the practices and procedures referred to in the preceding paragraph and to assess whether those practices and procedures can be expected to achieve the Commission's above-mentioned objectives. Two of the objectives of internal control and the practices and procedures are to provide management with reasonable, but not absolute assurance that assets for which the Company has responsibility are safeguarded against loss from unauthorized use or disposition and that transactions are executed in accordance with management's authorization and recorded properly to permit preparation of financial statements in conformity with generally accepted accounting principles. Rule 17a-5(g) lists additional objectives of the practices and procedures listed in the preceding paragraph.

Because of inherent limitations in internal control or the practices and procedures referred to above, error or fraud may occur and not be detected. Also, projection of any evaluation of them to future periods is subject to the risk that they may become inadequate because of changes in conditions or that the effectiveness of their design and operation may deteriorate.

Our consideration of internal control would not necessarily disclose all matters in internal control that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of the specific internal control components does not reduce to a relatively low level the risk that error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. However, we noted no matters involving internal control that we consider to be material weaknesses as defined above.

INDEPENDENT AUDITOR'S REPORT ON INTERNAL
CONTROL REQUIRED BY RULE 17a-5 OF THE
SECURITIES AND EXCHANGE COMMISSION

(Continued)

We understand that practices and procedures that accomplish the objectives referred to in the second paragraph of this report are considered by the Commission to be adequate for its purposes in accordance with the Securities Exchange Act of 1934 and related regulations, and that practices and procedures that do not accomplish such objectives in all material respects indicate a material inadequacy for such purposes. Based on this understanding and on our study, we believe that the Company's practices and procedures were adequate at December 31, 2005, to meet the Commission's objectives.

This report is intended solely for the information and use of the Board of Directors, management, the Securities and Exchange Commission, the National Association of Securities Dealers, Inc. and other regulatory agencies that rely on Rule 17a-5(g) under the Securities Exchange Act of 1934 in their regulation of registered brokers and dealers, and is not intended to be and should not be used by anyone other than these specified parties.

Hughlin & Associates

Seattle, Washington

February 14, 2006